RECEIVED
AUG 2 8 1995
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Review of the Commission's Regulations Governing Broadcast Television Advertising	)	MM Docket No. 95-90

COMMENTS OF NATIONAL BROADCASTING COMPANY, INC.

Richard Cotton
Ellen Shaw Agress

National Broadcasting Company, Inc.
30 Rockefeller Plaza
New York, New York 10112

Howard Monderer

National Broadcasting Company, Inc.
1299 Pennsylvania Avenue
Washington, D.C. 20004

August 28, 1995

RECEIVED
AUG 2 8 1995
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Review of the Commission's Regulations Governing Broadcast Television Advertising	)	MM Docket No. 95-90
	)	
	)	

COMMENTS OF NATIONAL BROADCASTING COMPANY, INC.

I. INTRODUCTION AND SUMMARY

In 1941 and again in 1959, the FCC adopted regulations that severely restricted the normal business activities and commercial relationships of broadcast networks and their affiliated stations.[1] The Commission believed these rules were necessary to protect affiliates from what was perceived as undue network influence and power, and to preserve and promote competition and diversity in the broadcast marketplace.

---

1 Report on Chain Broadcasting, Commission Order No. 37; Docket 5060 at 73-75 (1941); National Spot Sales Representation, 19 RR 1501 (1959) (hereinafter "1959 Report"). The Chain Broadcasting Rules applied only to radio until 1946, when they were also applied to television. Rules Governing Television Broadcast Stations, 11 Fed. Reg. 33, 37 (January 1946). The Chain Broadcasting Rules were repealed for radio in 1977. Report, Statement of Policy and Regulatory Policies Concerning Network Broadcast By Standard (AM) and FM Broadcast Stations, 63 FCC2d 674 (1977). The 1959 advertising rep rule has always applied only to television stations and networks.

NBC commends the Commission for launching a comprehensive reexamination of these so-called network rules. The instant proceeding focuses on two of the rules that continue to apply to television: the "network control of station advertising rates" ("station rate") rule and the "network advertising representation" ("network rep") rule. The station rate rule, which was adopted in 1941, was designed to keep networks from forcing affiliates to price their spot advertising below the network advertising rate, thereby reducing competition for national ad dollars and increasing network revenues at the expense of the local affiliates. The network rep rule is predicated on the same concern: that a network, acting as a sales representative for its affiliates, would have the ability and the incentive to price the affiliates' national spot ads at an artificially high level in order to give the network's advertising an advantage in pricing. The Commission was also concerned that a network might pressure stations into a representation agreement as a condition of affiliation.

There was never any evidence that, prior to the adoption of The <u>Chain Broadcasting Rules</u> in the early 1940's, radio networks required or even asked their affiliates to price their spot advertisements at a certain level. When it adopted the network rep rule nearly 20 years later, the Commission explicitly admitted there was no evidence that then-existing network spot sales organizations dominated the national spot advertising market, and no evidence networks unfairly pressured affiliates to choose the network as its spot sales representative. Nor was there any evidence that network-owned rep firms had priced affiliates' spots at an artificially high level. In short, both rules were based solely on the networks' potential power and ability to restrain competition "if they desired to do so."[2]

Even assuming these rules were justified over 50 years ago -- when broadcasting consisted solely of radio stations and three or four radio networks -- marketplace and competitive conditions today can no longer support severe government restraints on the commercial relationships between networks and television affiliates. The mass media marketplace and the competitive position of broadcast networks and local stations are drastically different now than they were five decades ago.

The station rate and network rep rules typify ancient regulations that have remained on the books long past the existence of any competitive or public interest justification. There is no marketplace failure that government regulation must remedy. The potential for abuse is not a sound or appropriate

---

[2] 1959 Report at 1513.

basis for government interference in normal commercial relationships when there is absolutely no evidence that such abuse is even remotely likely to occur. Moreover, the competitive concerns the rules attempt to address can be met through enforcement of the federal and state antitrust laws. Finally, the costs imposed by the rules, particularly the network rep rule, far outweigh any elusive benefits they may confer.

As NBC will demonstrate in these Comments:

- Dramatic changes in the national advertising marketplace, including both the manner in which national advertising time is sold and the number of outlets competing for national advertising revenues, have obliterated any rationale for the station rate and network rep rules;

- Vastly increased competition in the television marketplace has also eliminated any possibility that broadcast networks might have the ability to force their affiliates to act in a manner that is inconsistent with their best interests or the public interest;

- Even if networks possessed the power of coercion over their affiliates, they would not exercise it by manipulating their affiliates' spot advertising rates because such an enterprise would not be successful or profitable;

- The cost of maintaining the network rep rule, in terms of competition among the firms that represent local stations in the national spot advertising market and in terms of the competition among stations for national spot advertising dollars, far outweighs its benefits.

For these reasons, NBC urges the Commission to repeal both the station rate rule and the network rep rule immediately and in their entirety.

II. CHANGES IN THE MARKETPLACE HAVE ELIMINATED ANY JUSTIFICATION FOR THE STATION RATE AND NETWORK REP RULES

The Commission seeks comment on whether the factual determinations that led it to believe the station rate and network rep rules were necessary are still accurate today. Clearly they are not. When the rules were adopted, the Commission concluded that broadcast networks and stations were the only competitors in the national television advertising market; that the overwhelming majority of stations were network affiliates; and that therefore networks possessed the incentive and ability profitably to raise network and national spot advertising prices above competitive levels. For the same reasons the Commission believed that networks and their affiliates had an incentive to reach collusive agreements to raise prices above competitive levels. The Commission also believed that networks had the power to force their affiliates to act in a manner that was inconsistent with the affiliates' best economic interests, which might ultimately be harmful to the public interest.[3]

---

[3] Notice of Proposed Rulemaking, MM Docket No. 95-90, at par. 13 (hereinafter "NPRM").

None of these conclusions could be reached today.

A. Television Broadcast Networks and Stations Are Not The Only Competitors in the National Television Advertising Market

The NPRM indicates the Commission intends to analyse the national advertising market using the same analytical framework as in the television station ownership proceeding (MM Docket No. 91-221), and to review the filings made in that Docket in connection with its deliberations on the station rate and network rep rules.[4] NBC therefore refers the Commission to the Economic Analysis filed by Economists Incorporated in the TV station ownership proceeding, which contains a comprehensive analysis of the relevant advertising markets.[5] The Economic Analysis demonstrates that today the national advertising market is fiercely competitive and broad-based, and that it encompasses not only broadcast television (network, spot and barter), but cable television, radio (network and spot), newspapers and national print media, yellow pages, direct mail, outdoor and "other" media. Video advertising comprises only about 29% of the total national advertising market, and, according to the Economic

---

4 NPRM at pars. 21-22.

5 "An Economic Analysis of the Broadcast Television National Ownership, Local Ownership and Radio Cross-Ownership Rules," filed by Economists Incorporated on behalf of NBC, CBS Inc. and Capital Cities/ABC, Inc. in MM Docket No. 91-221 on May 17, 1995 (hereinafter "Economic Analysis").

Analysis, national advertisers freely substitute the various national video advertising media for each other, and substitute non-video media for video media.

Even if the Commission chooses to focus exclusively on the narrower national video advertising market, advertisers today have a number of different media to choose from that simply did not exist in 1941 or 1959:[6]

- According to the figures used in both the Economic Analysis and Appendix A of the NPRM, cable networks and barter now comprise over 16% of the national video advertising market, and their share continues to grow.[7] There are over 150 national and regional cable networks, the vast majority of which are advertiser supported. In the upfront 1995-96 selling season, basic cable networks are reported to have realized $2 billion.[8] Barter syndication, which according to the NPRM generated at least a $1.6 billion dollars in 1993, was non-existent until the early 1980's. In addition,

---

6 In the station ownership proceeding, the Commission tentatively excluded spot sales from the national video advertising market, stating that spot sales were not designed to give advertisers the same national reach as network advertising (Further Notice of Proposed Rulemaking in MM Docket No. 91-221, par. 37). NBC does not agree with this conclusion. The Economic Analysis demonstrates that network and national spot advertising are competitors. However, if the Commission ultimately concludes that networks and stations are not direct competitors for national advertising dollars, the fundamental rationale for the station rate and rep rules will be destroyed.

7 As recently as 1983 cable and barter accounted for less than 5% of all national video advertising revenues. NPRM Appendix A.

8 Broadcasting & Cable, June 19, 1995 at p. 27.

wireless cable and satellite-delivered program services continue to expand their reach.

- In the last decade, three new advertiser-supported broadcast networks -- Fox, UPN and Warner Brothers -- have been launched. These networks represent new and increased competition for national advertising revenues. The Fox Network is reported to have realized between $900 million and $1 billion in upfront sales for the 1995-96 season, and, according to the head of sales for one of the newer broadcast networks, "we have more money at work than we have inventory."[9]

- The number of commercial television stations has increased three-fold since the network rep rule was adopted, from 510 in 1959 to over 1500 today.[10] While the number of network affiliates has increased somewhat, the most dramatic increase has been in the number of independent stations, which, according to the Commission, numbered 450 in February, 1994.[11]

Thus, if national broadcast advertising -- network or national spot -- were priced above competitive levels, advertisers could and would quickly turn to a number of video and non-video alternatives. The growth in the number of alternative, competing advertising vehicles alone is grounds for elimination

---

9 Broadcasting & Cable, June 5, 1995 at p. 9.

10 Report and Order in re Review of the Prime Time Access Rule, MM Docket No. 94-123 (released July 31, 1995) at par. 27 (hereinafter "PTAR Order"). The NPRM indicates the Commission intends to include the record in the PTAR proceeding in connection with the issues relating to the national advertising market and the relative bargaining power of networks and affiliates raised in this proceeding (NPRM at par. 22).

11 Ibid. This number includes stations affiliated with the Fox, United Paramount and Warner Brothers Networks. If Fox, UPN and WB affiliates are not counted, the record in the PTAR proceeding indicates that there are about 150 truly independent stations.

of the rules. As the Network Inquiry Special Staff suggested 15 years ago, now that the number of advertising alternatives has increased sufficiently to eliminate the potential ability of any single network to set prices, there is no need to retain rules premised on the notion that networks have the power to manipulate the advertising market.[12]

The Commission recently concluded, on the basis of the evidence presented in the Prime Time Access Rule proceeding, that "none of the networks (or their affiliates) appear to exercise undue market power...in the national television advertising markets" [sic].[13] This conclusion inexorably follows from the fact that broadcast networks and stations today face significant competitors for national advertising. Assuming a network wanted to keep the national spot rates of its affiliates artificially above competitive levels, the amount and degree of competition that exists today in the national advertising marketplace would make successful rate manipulation impossible and unprofitable, whether the network acted unilaterally or in collusion with its affiliates.

---

12 Network Inquiry Special Staff, New Television Networks: Entry, Jurisdiction, Ownership and Regulation, Final Report (October 1980) at 495 (hereinafter "Network Inquiry Report").

13 PTAR Order at par. 52.

B. The Way Network Time Is Sold Today Makes It Impossible To Manipulate National Spot Pricing So As To Compare Unfavorably With Network Advertising Time

Wholly apart from the vastly increased competition for national advertising revenues, there have been profound changes in the way network advertising is sold -- changes that preclude market-by-market competition between network and national spot advertising and obviate the concerns that led to the adoption of the rules in question.

In the early days of television and during the period on which the Commission focused in its 1959 Report, most programs were furnished to networks by "sponsors" who would also provide all the advertisements in their shows. Such advertisers would purchase the time for their programs from the networks at a rate consisting of the total sum of the "network station rates" of all of the network's affiliates that the advertisers ordered and that agreed to clear the advertisers' programs. The "network station rate" typically appeared on a network rate card, and was usually the same rate contained in the network affiliation contract that formed the basis for the network compensation each station received. Even when programs were produced by or licensed to networks and resold to advertisers on a sponsorship or participation basis, a separate charge was made for network advertising time, based on the sum of these individual "network station rates."[14] The "network station rates" were public knowledge and, in fact, were listed in TV Factbook.

In a market like this, it was easy to compare each station's "network rate" and its spot rate. An advertiser could easily decide to buy the same station either by purchasing a network ad or a spot ad, depending on the price of the "network station rate" versus the cost of spot advertising on the station. Theoretically, a network would have a reason to want affiliates' spot rates to be as high as possible, particularly if the rates were higher than the network's price for advertising time. Similarly, a network spot sales rep would theoretically have a motive to advise the station to price its spot rates high.

A totally different system prevails today. Virtually all network advertising is sold in the form of packages of announcements. These announcements are placed in many different programs so as to achieve a specified quantity of viewership by an audience with specified demographic characteristics. The value assigned to each announcement in a package is determined by the viewership it is expected to achieve across the network distribution system, and by negotiation between network and

---

[14] See, House Committee on Interstate and Foreign Commerce, Network Broadcasting (the "Barrow Report") H.R. Rep. No. 1297, 85th Cong. 2nd Sess. (1958) at 402.

advertiser. A network may offer an advertiser a guarantee that its announcements will be viewed by a minimum number of persons having specified demographic characteristics, but no guarantees are made that specific affiliates will broadcast the announcements.

An individual station's "network rate" is immaterial to this transaction. Today this is a term in the affiliation contract used only to determine network compensation, and it is doubtful that any advertiser even knows what any affiliate's network rate is. Networks no longer publish network rate cards, and an affiliate's "network rate" is no longer listed in TV Factbook.

In these circumstances, a network -- either directly by dictating the rate at which an affiliate sells non-network advertising time, or indirectly through national spot sales representation of the affiliate -- cannot manipulate an affiliate's rate to make it compare unfavorably with the network's rates for the same market. No one figures out station-by-station what the comparable charge is for a network versus a station buy because no one purchases advertising that way.

Thus, changes over the past 35 years in the way network time is sold have totally eliminated the basis for any concern that station rates could be manipulated by a network to the detriment of competition in the national advertising market and the welfare of stations and viewers.

III. THE NETWORKS HAVE NEITHER THE ABILITY NOR THE INCENTIVE TO INFLUENCE THEIR AFFILIATES TO ACT IN A MANNER THAT IS NOT IN THE BEST INTERESTS OF THE STATION AND THE PUBLIC INTEREST

A. Networks Do Not Have The Power To Force Affiliates To Act Against Self-Interest Or The Public Interest

In response to the Commission's request for comment on whether broadcast networks have sufficient bargaining power to cause their affiliates to price spot advertising revenues so high as to inhibit the stations' ability to serve the public interest, NBC refers the Commission to the Comments and Reply Comments filed by NBC in the PTAR proceeding, and the accompanying economic study filed by Economists, Inc.,[15] which deal extensively with the issue of network/affiliate bargaining power. The record in the PTAR proceeding demonstrates that affiliates have gained significant bargaining power relative to their networks in recent years, making impossible the type of undue influence over affiliate operations the rules at issue here were designed to guard against.

Indicia of increased affiliate bargaining power, which are

---

[15] An Economic Analysis of the Prime Time Access Rule, filed in MM Docket No. 94-123 by Economists Incorporated on behalf of NBC, CBS Inc. and Capital Cities/ABC.

reflected in the record of the PTAR proceeding and noted by the Commission in the PTAR Order[16], include the following:

- Stations today may choose from many alternative national programming services, including the Fox, UPN and Warner Brothers networks, as well as a vibrant syndication market, which provides attractive and popular first-run programming to stations that do not have a network affiliation;

- Recent affiliation switches, including at least 21 from NBC, CBS or ABC to Fox, demonstrate that stations now have more options in terms of national programming services. Competition among networks to attract and retain affiliates during this period resulted in dramatically increased affiliate compensation;

- The total amount of network programming during non-prime dayparts has declined over the years, evidencing the inability of networks to dictate to their affiliates.

These facts led the Commission to conclude in the PTAR proceeding that "affiliates have gained greater bargaining power since the adoption of the [PTAR] rule..." in 1970.[17] Certainly the balance of bargaining power has shifted towards affiliates since the days of NBC's Red and Blue radio networks in the 1930's, and the Barrow Report of the 1950's. Even in 1959, when almost every station was affiliated with one of only three networks, there was no evidence that networks "tied" affiliations to a station's willingness to hire the network as its sales rep, or made any attempt to influence the pricing of a station's non-

---

16 PTAR Order at par. 106.

17 PTAR Order at par. 114.

network advertising time. Today's station licensees are experienced, knowledgeable and sophisticated in their sales policies and practices. The management of each station (not the spot rep) sets its own rates and advises its rep regularly as to what those rates are. These station owners could not be persuaded or coerced by a network to charge national spot rates that are less then fully competitive.

It defies any rational view of the current network/affiliate relationship to suggest that a network could coerce an affiliate to act in a manner that is contrary to its economic self interest and that would restrict its ability to present programming responsive to local needs and interests. With the ever-increasing number of programming choices available to stations and viewers, the networks' primary concern today is maximizing the audience that watches network programming. One of the primary issues in the network/affiliate relationship from the network's point of view is the affiliate's clearance of network programs -- clearance which makes possible the huge financial risks required to finance original entertainment, national and international news and major sports programming. No network is going to jeopardize the clearance of its programming by trading clearances for an agreement by an affiliate to price its spot ads higher than it would otherwise, particularly since, as discussed below, the economic benefits to the network are virtually non-existent. Nor would it make sense for a network to trade clearances, or to affiliate with a less desirable station, simply to get a new customer for its ancillary station rep business.[18]

Finally, any attempt by a network to force its affiliates to set advertising rates at above competitive levels (or any network/affiliate agreement to do the same), would probably amount to price fixing, and could readily be addressed through enforcement of federal and state antitrust and unfair competition laws.

B. Networks Do Not Have The Ability Or Incentive To Influence Affiliates' National Spot Advertising Rates

Even if networks had the power to force affiliates to price their national spot ads too high, there would be no incentive for the network to exercise that power. Nor would a network and its affiliates, acting in concert, have the incentive or ability to manipulate national advertising rates to their advantage. It would simply not be profitable for the network, alone or in collusion with its affiliates, to pursue such a scheme. This is because, as discussed above and more fully elucidated in Section III of the Economic Analysis, national advertisers have a host of video and non-video alternatives to network and spot advertising time.

---

[18] This would be true even if it were not the case that the station rate and network rep rules are premised on network sales practices that no longer exist.

In today's competitive environment, it would be absurd to suggest that a single seller in the national advertising market could benefit from the type of rate manipulation the station rate and network rep rules purport to prevent. Given the number of alternative national advertising media, there is no guarantee that the dollars diverted away from the over-priced affiliate would end up in the pocket of its network. Even if a network were able to force its own affiliates to price themselves out of the market, it would still face competition from five other television broadcast networks, the affiliates of those networks, independent stations, cable networks and barter -- just to mention the video advertising media available to national advertisers. Similarly, if a network-owned national spot rep caused a client station to price its spots at an artificially high level, it would simply fail to sell any spots. No station could afford to retain such a rep. Nor could any network-owned rep firm afford to devote personnel and resources to so futile an effort, especially since there is no guarantee that advertising dollars diverted from the overpriced national spot client would flow to advertising on the network that also owns the rep firm.

But there is another important reason why networks' lack the incentive to cause their affiliates to price their national spot advertising at uncompetitive levels. It is in a network's self interest to be affiliated with the strongest possible local stations -- stations that are first in their markets with local news and attractive syndicated programs. A spot ad price manipulation scheme that reduces the revenues available to affiliates for local and syndicated programs ultimately results in a weaker affiliate line-up for the network, lower network ratings and lower network revenues. The likelihood of lower network ratings and revenues is far more certain than the outside chance that the network's ad sales will be inflated because its own affiliates alone have overpriced their national spot time. Networks' critical need for affiliates with strong local programming may not have been a factor decades ago, when there were only three networks, few independent stations and no cable networks. But it is certainly a major factor in network/affiliate relations today.

IV. THE COSTS OF THE RULES OUTWEIGH THEIR BENEFITS

As we have demonstrated above, the station rate and network rep rules are totally without justification in today's marketplace. However, they are not without cost. As the Network Inquiry Special Staff recognized, there are efficiencies inherent in network sales representation of affiliates that are lost on account of the prohibition. To the extent networks are more efficient than their competitors, these lower costs could be passed on to both the stations represented and the advertisers buying time on those stations. In fact, the Network Inquiry Staff found that network owned and operated stations represented in-house tended to sell spot time at lower rates than other stations.[19] Moreover, the station rep business has become highly concentrated, with five or six firms representing the vast majority of commercial television stations.[20] Allowing networks to represent their affiliates would provide those stations with an additional option in choosing a rep firm, and would increase competition in the rep firm business.

Since there is no public interest basis for an FCC rule prohibiting networks from setting station advertising rates, or for a rule that prohibits network companies alone from becoming the national sales representative of any station that wishes to hire them, there is no reason for the marketplace to continue to bear the loss of operating efficiencies and competition the rules impose.

---

[19] Network Inquiry Report at 493-94.

[20] 1995 TV & Cable Factbook at H-33.

V. CONCLUSION

For the foregoing reasons, NBC urges the Commission immediately to repeal the station rate rule and the network rep rule in their entirety.

Respectfully submitted,

Ellen Shaw Agress

Richard Cotton
Ellen Shaw Agress

National Broadcasting Company, Inc.
30 Rockefeller Plaza
New York, New York 10112

Howard Monderer

Howard Monderer

National Broadcasting Company, Inc.
1299 Pennsylvania Avenue
Washington, D.C. 20004

August 28, 1995